

DECEMBER 04, 2012 / 2:00PM, TWTC - tw telecom inc. at UBS Global Media and Communications Conference

**John Hodulik - UBS - Analyst**

And then maybe a little bit about the intelligent network initiative. I mean, are these products in the market right now and do you have any initial feedback in terms of customer acceptance? And is it helping driving incremental revenue per customer?

**Mike Rouleau - tw telecom inc. - SVP, Business Development and Strategy**

Yes, so the first two sets of features, the enhanced management capabilities and the dynamic capacity services, are in market today. And it's still pretty early. We haven't really had them in market that long, but I can tell you that as I talk with customers -- and I spend the vast majority of my time on the road in our markets with our customers -- they are intrigued and interested in those sets of capabilities.

Even those big customers that might have their own performance management solution are intrigued by our capabilities, because we give them a different view. It complements what they're already doing.

And so, they can use both services, both sorts of capabilities to manage their networks better. And because nobody else had a bandwidth-on-demand solution like we do with our dynamic capacity, we think that gives us a very different position with our customers, with our prospects. We sort of look at it as a way for customers to have more control over their unpredictable operating environment.

I mean, it's really hard for customers to look three or five years out now and say, here's exactly what I need, when they're being faced with, how do I manage this promotion this week or healthcare enrollment this month or these new applications that pop up for a particular period of time. They want to have that level of flexibility.

And so this gives us a great opportunity to work with them in a different way.

**John Hodulik - UBS - Analyst**

So, do you -- I mean, do you see these new services just as a differentiator to win business?

**Mike Rouleau - tw telecom inc. - SVP, Business Development and Strategy**

Oh, absolutely.

**John Hodulik - UBS - Analyst**

Or is it potentially to, again, generate more revenue per customer as we sort of move on?

**Mike Rouleau - tw telecom inc. - SVP, Business Development and Strategy**

So, we always say "yes," because it is an opportunity for us. When a customer's evaluating a service provider and they say, all right, I can get Ethernet from all these guys, or I can get Ethernet from you that also has dynamic capacity, that also gives me visibility, that also gives me reach to the cloud, right? Well, that's -- we believe it sort of tips the scale in our favor, right?

So, we also think that it's a sticky sort of solution, right? So, it's great for customer retention. And, yes, it is incremental revenue.



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**John Hodulik - UBS - Analyst**

Right. Can you talk a little bit about the size and stability and maybe productivity you've seen in the sales force? I think there was some talk about you guys ramping up the sales force, where you are in terms of distribution?

**Mark Peters - tw telecom inc. - EVP and CFO**

Yes, I mean, when you think about our distribution, and our talk about expanding our sales force, you've seen like over the last year or so, third quarter over third quarter, that have declined -- gosh, I don't remember the number, maybe about 40 sales people, year over year, if I remember the number right. And we were -- we've been doing some refocusing and working on modules with the sales organization and while we're doing that, we didn't want to be making big changes and additions along the way. We wanted to get it all kind of settled out, which it is now.

So, our expectation is over the next several quarters or a year is to bring the sales headcount up and beyond where it was a year ago.

So, that's what we expect to do, just to continue to expand that reach, both from national sales to local sales to our government sales to our channel sales, in different categories throughout the Company, to expand that reach.

**John Hodulik - UBS - Analyst**

And what about, maybe, some just commentary on the overall economy? I mean, a lot of business companies -- customers -- or companies that serve the business community are saying that they're saying customers wait, given all the fiscal cliff and issues like that. I mean, what are you seeing out in the market these days?

**Mark Peters - tw telecom inc. - EVP and CFO**

I'll start and Mike might add in some more, too. Our sales have been actually pretty steady when you look at the trend line, well, steady when you look at the overall line. We've had ups and downs from quarter to quarter, as we talked about a little bit, but when you look at it, really it's pretty steady.

It's hard for us to say the economy, fiscal cliff, however you want to look at it, is causing enterprises to behave differently. We haven't seen that specifically. As we keep -- we're out there. We're a share taker. We -- with the products we've talked about, both today and what we've had, quite honestly, as far as our delivery capabilities, we do pretty good in just about any economy.

During the Great Recession, our lowest growth year in revenue was about 4.5%, because, ultimately, like I mentioned before, we have \$1.5 billion in revenue. While that's a big number, it's also pretty small relative to the big guys, so, there's a lot of opportunity for us to go after.

And we think, with -- like Mike was saying about the dynamic capacity, if we're selling -- if there were like products that we're selling with somebody else, and then we can say to a customer that's uncertain about their business, you can get the same offering, but then you know that if your business grows, you can just dial that up and you can get it when you need it. That's pretty compelling from a differentiation.

So, from the economy standpoint, there's noise out there, but it's hard to say that's what caused this impact to sales. So, I can't really hang my hat on that.

**John Hodulik - UBS - Analyst**

Right. I mean, in the past, you guys have talked about churn in the business space and I remember during the sort -- sort of the heart of the recession, that had ticked up and was impacting the sales. Are those -- is -- are those trends heading the right direction?





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**Mark Peters** - *tw telecom inc. - EVP and CFO*

Our churn rate has actually been pretty stable, as you see from our chart. Our churn ranges between -- our revenue churn is right around 0.8% to [0.1%]. It's kind of in that range. I think the last quarter was about 0.8%.

Re-rates are not calculated in there, and we'll see some of those, because while the competitive environment hasn't changed, it is a highly competitive environment, and we're not in an environment where price per bit is going up; it's the reverse. So, when we renew contracts, like for like, if we're not selling more services, more capabilities, more capacity, more locations, per bit's going to -- it's going to go down on the contract renewal.

So, that's -- that's a factor, too, that we always have to outrun with our new sales to keep the growth rate going.

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**John Hodulik** - *UBS - Analyst*

Got you. Okay, we have some time to open it up to questions from the audience. First right here on the side. Okay.

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**Unidentified Audience Member**

I understand the competitive advantage that -- with the dynamic capacity management, but what prevents some of your deeper-pocketed competitors from developing and offering the same technology?

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**Mike Rouleau** - *tw telecom inc. - SVP, Business Development and Strategy*

Yes, I think as I mentioned, and Mark also spoke about, we have taken a different approach to deploying services and infrastructure. So, we have a strategy to deploy one set of network elements across a common platform and build an integrated back office to give a customer a consistent experience with us, service experience and product experience across the country.

Our competition is not in that same position. So, they have a challenge in having to do business one way in one part of the country and another in another part of the country. And we know this because we do business with these guys, as well, right? So, the way I do business with an incumbent in Florida is different than what I do in Texas, different than the way we do business in California or New York.

And so, you can't deploy the types of services that I talked about across this disaggregated sort of infrastructure and platform. You have to have consistency.

And so we have a distinct advantage, time-to-market advantage, because of the approach we've taken to get to market with that one platform and others are going to have a hard time catching up to that, unless they sort of start greenfield and build it from scratch, because billing systems are different with them, they have different product sets, they have a different set of network elements. And you have to be able to control all of these disparate devices, which becomes very challenging for them, right?

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**Mark Peters** - *tw telecom inc. - EVP and CFO*

And if you just think about -- and you know who they are -- the companies that have done, serial acquirers, big and small, and their networks look different, their systems look different, their databases aren't combined and integrated, to try to give a common view across the country and do it efficiently, embedded in the network like we have, it's just -- it's really difficult to do.

I mean, think about that. If you're a customer of ours in Miami and you have a location in Seattle and Minneapolis, and you see that you need to turn up capacity in one or the other, and you can just move the bar across there and turn it up as you're moving the bar, for another company to



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do that, because of their multiple different operating systems throughout the country, like Mike said, they'd have to build something to completely overlay the whole environment.

Now, one thing I wanted to point -- I don't remember if Mike said it -- is that we've embedded this capability into our network. So, when I sell these services to you, I don't have to give you -- build a special solution for you. It's embedded in our network.

So, if I sell dynamic capacity to you, I don't need to put something special, build something special for you. Now, another carrier might do a custom job, just for you, but then it's a custom job for you, and just not scalable. The returns on all that's really difficult.

And when you think about it, when you pull that bar over and you buy more capacity from us, I don't -- you don't have to call somebody to sign a contract. You don't have to call somebody to roll a truck. You don't have to call a billing person to start the billing. When you signed up at the beginning, we have all the agreement in place. You move that, you get the capacity, it goes into our billing system, we bill you. There's no people involved on our side, so it's a very efficient delivery and a nice incremental margin on that, what you buy under that service offering.

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**John Hodulik - UBS - Analyst**

You talk about the value of the integrated platform, if you were to merge with or acquire new assets, is there any -- does this complicate the integration process, or how do you overlay this system on new assets that you would try to integrate into your network?

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**Mark Peters - tw telecom inc. - EVP and CFO**

We've done two larger acquisitions over time. We're not a serial acquirer, but we've done them all very successfully, because, number one, we go in with our eyes wide open. We know what it takes in cost to do it.

But it's a highly scalable platform for us, and so what we can do is because we have the infrastructure in place and I think we have the skill in place that we know how to scrub, clean, and transfer data into our platforms. We know how to integrate the networks and deploy the -- our infrastructure across the networks.

If, because of, quite honestly, that story of ones that we've created, it actually makes it easier for us, if we found something that we thought the cost/benefit really made sense -- and we haven't found one of those since 2006 -- I think we could do it very efficiently.

But we're also realistic about what it costs to deploy our products, because there just aren't that many companies out there that have the characteristics that makes it cost effective for us to say, okay, here's the multiple we have to pay, but then this is what it costs us to integrate it, both from capital dollars and operating dollars and distraction to the business. And that's why you just haven't seen us do many.

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**John Hodulik - UBS - Analyst**

With that in mind, I'm just wondering to what extent you do see properties out there that look like they might be workable, something you'd want to consider consolidating, in one way or another?

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**Mark Peters - tw telecom inc. - EVP and CFO**

We look at, probably, virtually everything out there. Most of them come across our desk that are available, just because we have such a strong balance sheet and we have the capacity to do an acquisition, if we could find the right one.

And we do -- it goes in spurts where we see opportunities out there. The challenge that we have is, though, we think we're a pretty unique company, and we see companies out there that, then, want a valuation that exceeds ours by a lot, and then we have to invest a lot of dollars to make them





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work into our model. And a lot of times, as you know, when you do an acquisition you look for cost synergies, as well. And a lot of times they don't have cost synergies that take out, we actually have to put stuff in to make it operate.

So, there just-- there just be assets versus an operation that really works for us. So, we have to balance what we're going to deliver to -- it sounds kind of trite, but shareholder value. Where are we going to see the return? So, while we keep looking, we don't see much, at least we haven't.

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**Unidentified Audience Member**

How does the growth in your dynamic bandwidth product impact your capital intensity of the business?

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**Mark Peters - tw telecom inc. - EVP and CFO**

So, the growth in the bandwidth that we're selling? We balance that and it kind of goes with my comment before, I suspect, where we see the price per bit that we can sell it for go down. The good thing, though, the infrastructure, and the technology continues to improve at a rapid rate.

So, when we put the new infrastructure in place, the new technology, which we do continually, it's much more efficient than what we might have deployed just three years ago. So, we can deliver a lot more, from a capital standpoint, a lot cheaper. So, that's why it also helps us to continue to expand that ROIC.

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**John Hodulik - UBS - Analyst**

Okay. Any other questions from the audience? Okay. Guys, thank you very much for being here.

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**Mike Rouleau - tw telecom inc. - SVP, Business Development and Strategy**

Thank you.

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**Mark Peters - tw telecom inc. - EVP and CFO**

Thanks, everyone.

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**Attachment 21**

# EDITED TRANSCRIPT

LVL T - Level 3 Communications at Bank of America Merrill Lynch Media, Communications & Entertainment Conference

EVENT DATE/TIME: SEPTEMBER 12, 2012 / 4:30PM GMT





SEPTEMBER 12, 2012 / 4:30PM, LVL3 - Level 3 Communications at Bank of America Merrill Lynch Media, Communications & Entertainment Conference

## CORPORATE PARTICIPANTS

**Jeff Storey** *Level 3 Communications - President & COO*

## CONFERENCE CALL PARTICIPANTS

**Michael Funk** *Bank of America Merrill Lynch - Analyst*

## PRESENTATION

**Michael Funk** - *Bank of America Merrill Lynch - Analyst*

We normally have Jim and Tina come out and we always love having Jim at our conference, but I think in having Jeff here today it's certainly special given how important his role is in the business. There's so many questions revolving around the integration process. And for those of you not familiar with Level 3's story, obviously there were some integration issues back in 2007, in 2008, and Jeff was brought in, in large part, to help resolve those issues. And with the recent acquisition of Global Crossing, there are once again questions about the integration. So we certainly want to touch on that today. I think Jeff had a few opening remarks to begin.

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**Jeff Storey** - *Level 3 Communications - President & COO*

Sure. So I'll just talk a little bit about Level 3's business to make sure everybody is level set on who we are and what we do. We operate in three regions, North America, Latin America, and EMEA and over the course of the first half of the year, we've talked about our results in each of those regions. The story is our wholesale business is largely flat and our enterprise business is growing, and that's kind of the story in each of the areas as well. Wholesale in North America is flat to slightly growing through the year, but the enterprise business is growing nicely both in large enterprise, and midmarket, and our US government business. In Latin America, the enterprise business is growing very well. Wholesale has been largely flat.

In Europe, it's a little bit of a different story. Our wholesale business is about the same, flat to slightly increasing. But the UK government business has been an area of decline for us. Most of these contracts were lost prior to the acquisition of Global Crossing, but we've seen the revenue trail off as those contracts have transitioned to other providers. We've given an indication that we think that will largely be behind us by the end of 2013. But that's had an effect on our ability to grow re in EMEA and overall as a Company as those contracts have rolled off.

Our enterprise business in EMEA is at the beginning stages. If you listened to our earnings calls at the beginning of 2009, we would have talked about what we were going to do to grow enterprise business in North America, both large enterprise and midmarket. There was a fair amount of skepticism. Level 3 is a historically wholesale company. Are you really going to be able to grow those enterprise customers. We think that over the past three years, we've proven that we can. We're in the same position in EMEA right now. We have an excellent network. We have excellent products. We have good market dynamics that customers need the types of services we sell, but it's up to us to execute and we have to grow the enterprise business in EMEA.

Overall, we've given guidance on the second quarter earnings call that we will accelerate revenue growth in the second half of the year. I've been asked a number of times, well, is that the third quarter or the fourth quarter? It is what it is. We'll accelerate revenue growth in the second half of the year and stick with that statement that we made from prior meetings.

So with that, that's kind of the introductory comments and I look forward to questions.

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## QUESTIONS AND ANSWERS

**Michael Funk** - Bank of America Merrill Lynch - Analyst

No, I appreciate it. Maybe just stepping back again to your role as Mr. Fix It, and I think in 2008 and '09, you'd have a slide you'd show where all the different moving pieces and trying to go from sales to order delivery and obviously there was some broken pieces in that process. And if we had a similar slide today for Level 3 in Global Crossing, are there any points of concern similar to the other acquisitions?

**Jeff Storey** - Level 3 Communications - President & COO

Yes, I've told a couple of people in the last day, I'm a very paranoid person. I worry about everything we do and so I break that whole process down from the time we start thinking we need a sales rep, not just when we send the sales rep, but when we start deciding we need a sales rep all the way through billing. We break that whole process down into various pieces. And then looking at what can go wrong, what can prevent us from being successful in each of those areas.

So we work very hard across that entire flow to make sure that we aren't creating any problems for ourselves. We have in the past in prior acquisitions, we sometimes set a guidance out there or set a timeline in our own head, and regardless of whether we really were ready to meet that synergy or ready to do that action, because it had been six months we laid off another 300 people. Or it's been nine months so cut this system out. This time we're much more milestone based. We looked at that whole flow across the business and said, if we're going to do synergies in service delivery, what are the drivers of that? It's not time. It's that we've gotten the processes integrated, that we've gotten the inventory integrated, we've got the platforms ready. And so we have made sure that our synergies and all of our efforts are based on timelines and the precedents that are necessary for making those next steps have been met, rather than just having a plan and sticking to the plan no matter what happens.

So we've paid particular attention to the customer experience and what the customers are telling us, and it's my experience that the customers will tell you the truth if you're just asking them and you're listening to them, and that's our guiding principle.

**Michael Funk** - Bank of America Merrill Lynch - Analyst

And what's your average time of day from order to revenue recognition?

**Jeff Storey** - Level 3 Communications - President & COO

It's probably 60 days from the time that we get an order until we on average recognize it, but there's huge variability in that. If it's a non-net circuit for capacity between two endpoints that we already serve, we can do that in ten days. Many times, customers will do a large project with a customer and it will be a six to nine month transition. That's at their request to make sure that we're fully integrated with the transition they're doing inside their business.

So the variability is broad, but it's probably 60 days is the average.

**Michael Funk** - Bank of America Merrill Lynch - Analyst

And I wanted to touch a little bit on the guidance that you gave because I do get a lot of questions on it. I thought your commentary on your funnel in your order flow was relatively constructive in 1Q and even 2Q, talking about some of the trends that you saw. And then tying that with your 60-day average comment, it would just seem very high level that the revenue trends should be improving going from 2Q to 3Q, so why wouldn't they? What are the points of concern there?



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**Jeff Storey** - Level 3 Communications - President & COO

Well, let me just tell you what goes into and you make up your mind as to whether they're going to be in the third quarter or the fourth quarter. We talked in the first quarter earnings call that January and February sales were light, but that we had a strong March. That obviously affects revenue in the second quarter. We talked in the second quarter that the sales, I don't know if that's the airplane hitting the building or what, but the sales in the second quarter were strong. They were comparable to the March sales that we had. So that is a positive impact for the second quarter.

We also talked, though, that the UK government declined slightly faster in the second quarter than we had expected. That transition is not up to us. It's up to others, and so it's a little hard for us to predict when that transition is going to occur. There's still more to come and so there are puts and takes that go into those numbers. From the sales perspective in the second quarter, we're pleased with the sales that we saw and we do see -- on the second quarter, we were pleased with the sales that we saw in the second quarter. We think that the ramp is nice and we're moving forward. Hopefully that sound will go away soon. No matter where I go, there's technical difficulty.

**Michael Funk** - Bank of America Merrill Lynch - Analyst

The synergies you recognize to date, \$125 million run rate, right, just to reiterate what you said, can you break that down for us into the piece part, what makes up the \$125 million? And maybe you can highlight it again. I think you talked about less than half of projected OpEx synergies coming from the network side. Maybe give us a sense of that \$125 million.

**Jeff Storey** - Level 3 Communications - President & COO

Let me back up and give you overall sense of the synergies that we expect with the Global Crossing deal. When we announced the deal, we said there would be \$340 million worth of run rate synergies. \$40 million in CapEx. We think that we've largely captured that \$40 million and that we're on track for that going forward, that that comes from vendor negotiations, that that comes from better buying power, that comes from a little bit of unnecessary redundant capital being spent, but mostly from the vendor negotiations. So we're there on that number. The rest is \$300 million, \$165 million of OpEx, and \$135 million of NetEx. We said that we would capture roughly two-thirds of that within the first 18 months. So after nine months, Michael's number of \$125 million, we've said that after the second quarter we had \$125 million in realized synergies, \$75 million of that from OpEx and \$50 million of that from the NetEx. NetEx is what we pay to a third party provider to provide our services.

So nine months in, halfway in we're at \$125 million versus the \$200 million for the first 18 months. So we feel very confident about our ability to hit both the \$200 million and the \$300 million that we've talked about in the past.

**Michael Funk** - Bank of America Merrill Lynch - Analyst

And \$125 million implies that you're running ahead of plan, right? SO if you think about hitting the 18-month timeframe, are you roughly equally splitting the remaining \$75 million over those quarters? Is that a conservative estimation and where do you see room for upside now that we are about I guess almost 12 months into the merger, right?

**Jeff Storey** - Level 3 Communications - President & COO

So I can see why you'd look at that number and say we're ahead of plan and wonder about where we're going to finish after the 18 months. But let me go back to my comment about our synergies are tied to milestones. And if I feel confident that we can capture those synergies earlier without harming our ability to grow, without doing something that effects our ability to deliver, then we will capture them earlier. I'm not giving any particular guidance about that. We will capture those synergies at the time that we meet the milestones where we think we're in a position to do it. But we still do feel very confident about the \$200 million by 18 months and the \$300 million overall.



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**Michael Funk - Bank of America Merrill Lynch - Analyst**

Another question I frequently get is around CapEx, and I think your guidance is for 12% CapEx to sales. You call that a longer term target as well, at least at the Company here, that runs over 20% CapEx to sales. If you can describe some of the differences at Level 3 versus some of the peers and why to keep a lower capital intensity?

**Jeff Storey - Level 3 Communications - President & COO**

There seems to be a lot of question about CapEx, so I appreciate the question. It's a historical number. If you look in 2009 when we were not growing, our CapEx was 9% of revenue. If you look at 2011, 2010, 2011 when we were growing, the end of 2011, at the 2% a quarter level, the 12% has been the right number. There are differences in our business than others. Number one, we have 100,000 buildings within 500 feet of our network. If a large part of our CapEx goes to adding buildings, we can add those buildings at a very low cost compared to somebody who has to build a mile or three-quarters of a mile to get to the building. We have to go 200 feet, 300 feet. And so we can do that at a different CapEx.

We also have scale and scope. We look at our overall business and recognize that our footprint globally gives us an advantage in how we deploy capital and gives us -- we can deploy big chunks of capital, which -- big capacity boxes, which come cheaper by unit further out into the network, further to the edge of the network, which drives our overall cost of capital down versus people with lower amounts of [amp], with lower amounts of capacity.

And then we also have buying power, buying power with vendors to get the best prices on equipment. And so I don't spend a lot of time looking at other people's capital versus revenue, but I'm very confident in our capital versus revenue. I'm confident that the 12% of revenue per capital gets us to the growth rate that we want to see for the business.

**Michael Funk - Bank of America Merrill Lynch - Analyst**

And then where do you expect to focus those CapEx dollars product wise or geographically? You talked about maybe increasing the CapEx, the legacy Global Crossing?

**Jeff Storey - Level 3 Communications - President & COO**

Yes, so there are a couple of areas where our focus has been. Number one, network reliability. We have opportunities in the combined Company to improve network performance in various areas and so we're spending some capital dollars to make sure that we provide the best quality of service as a combined Company. And so that's something that we've done particularly in Latin America to bring quality up to what our customers expect and what we expect for the business.

We also look at building local footprint. We think that the value of our network is a function of the endpoints that it's connected to. And so we're continuing to expand the buildings that are on that, building to those 100,000 buildings that are within 500 feet, or even adding more buildings by building loops within a metropolitan area market, adding more buildings closer to our network and investing in those.

And then lastly, in products, and in expanding our addressable market not just through the footprint, but also through the products and services that we offer. Our enterprise products are the fastest growing enterprise data products, whether they're Ethernet, private line, or IP VPN, or IP VIA type products to enterprise customers. Those are the fastest growing. We see a market shift in the needs that enterprise customers are having. We think enterprise CIOs need more help in managed services, they need more help in managed security. They need more help in making their IP VPNs operate the way they're expected to. And so, we are investing in capital in those product and those services, making sure that we have the managed security capabilities that our enterprise customers are expecting, and the managed service capabilities that they're expecting.



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**Michael Funk - Bank of America Merrill Lynch - Analyst**

How much of your guidance depended on number of sales people? I think you talked last quarter about maybe seeing a little bit higher than expected churn in your sales force, and productivity remaining I guess relatively stable. It's more of a factor of number of sales people. So how important is, I guess, adding sales people back into the mix, increasing their productivity versus, say, the economic factors and everything else?

**Jeff Storey - Level 3 Communications - President & COO**

The guidance we give is not dramatically effected by our sales people and we talk about the second quarter. Second quarter sales were strong and that's going to affect guidance more than sales people we might hire today to take nine months to bring up to speed. But for us to get back to that 2% or 2% plus per quarter growth that we want and that we expect, sales people are the key. We have to continue to work to find ways to add more sales people, but not only add them, figure out how to get them productivity quickly. But not only figure that out, but how to maintain and how to keep them. If we spend a year investing in a sales person and then they leave, we didn't make money on that sales person. We need to keep somebody two years to really get the bang out of them, 18 months to two years to really get that.

And so, if we can get a sales person on board, get them up to speed, get them trained and tenured and then keep them for one, two, three, four years, they're a much more productive sales person to us. So we look at that entire lifecycle of a sales person and are evaluating everything from recruiting, how do we change the way we recruit, hire people off the street, more college hires, other types. Bring them in, train them in Level 3. What can we do to make them more effective faster and then keep them longer once they've become effective. And that's absolutely critical for us to get to our 2% or 2% plus per quarter growth that we aspire to.

**Michael Funk - Bank of America Merrill Lynch - Analyst**

I think one of the first things that you did when you came to Level 3 was to help transition from more of a reseller model to kind of a boots and street sales force. So looking at that, I guess, how would you change how you built the sales force? And is the sales force built in the way that needs to be built, or are there ways, directions that you can go in to maybe improve that?

**Jeff Storey - Level 3 Communications - President & COO**

Yes, I think that there's certainly things that we can do to improve the sales force. Some of these are so maybe trivial, but I'll talk about them and maybe spark other comments. We look at the skill sets. We evaluate our sales people that are successful and say, what are the skill sets that they've had that may have been successful? What are the attributes, personality attributes, or whatever, that makes a successful sales person at Level 3? Because we don't think it's one answer for all sales people. At Level 3, what are those attributes? How do we recruit, attract, and acquire those? What about Level 3 is making it necessary, maybe you have to be really determined at Level 3 because it's hard to get a quote through the process. What can we do to improve quoting that makes that not as big of a burden or hurdle for the sales team?

And so, we're looking at the things that makes our sales teams successful, our sales people successful, and how do we either augment our platform, or change our selection process, or change our training process. We've done things like a lot of companies will go to their sales manager and say, your job is to fire non-producing sales people. And you ought to be firing your bottom 20%. I don't say that to our sales managers. I say, your job is to make sure that you don't have to fire anybody because they're not producing. Your job is to make sure they're producing and what are the -- your job is to remove barriers from them being able to sell, and what are you doing to make sure that every one of your people are successful.

Obviously, some people aren't going to be successful, but the emphasis and the priority for the management team needs to be that's your job, make them successful. Not just throw them to the wolves and hopes that it works out, but make them successful and drive the performance out of the sales team.





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**Michael Funk** - Bank of America Merrill Lynch - Analyst

And the performance that you are seeing in the order growth, is that mostly coming from existing customers? Is that from new customer growth? Where are you seeing that?

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**Jeff Storey** - Level 3 Communications - President & COO

I'd still say that the majority of our growth comes from existing customers, but we add hundreds of new customers every month. I get a report of every new customer that we get. I send a letter to every new customer that we get welcoming them to Level 3. I personally call some of the larger ones when we get them. But a part of our strategy with new customers is a wedge. Give us a little bit of your business. Let us prove ourselves. Once we get a little bit of your business, give us a little more. And so that strategy automatically means that the majority of your growth is going to come from existing customers because you're just getting a little up front and then you're winning more of their business as you go down the road.

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**Michael Funk** - Bank of America Merrill Lynch - Analyst

What's your share of wallet today, say, where it was a year ago or two years ago?

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**Jeff Storey** - Level 3 Communications - President & COO

Any given a particular customer?

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**Michael Funk** - Bank of America Merrill Lynch - Analyst

What you highlighted that maybe Level 3 isn't the dominant carrier at, say, a mid-sized enterprise. But you want to win more business so maybe you had 5% last year. You get 10% today. So what do you think your share of wallet is at your average customer today?

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**Jeff Storey** - Level 3 Communications - President & COO

I don't have an answer for that. I will -- I'll give you an aspiration, but it's not really an answer. I expect our share to double with our customers, not the high end where we already have a lot, but that [wedge strategy, I expect us to double, triple pretty quickly that as we use that wedge to win business from a customer that it truly becomes that. That we don't just sit back and be satisfied about that, but that we're using that experience with the customer for them, for us to go out and drive, and more penetration with them.

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**Michael Funk** - Bank of America Merrill Lynch - Analyst

Okay, and just thinking about some of the drivers, I think historically you have a slide that showed kind of growth in demand and then the change in pricing. Do you have thoughts on expanding that post Global Crossing when you think about kind of the regional differences as well, some sort of [high] differences in demand in price in Lat Am versus the US and Europe?

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**Jeff Storey** - Level 3 Communications - President & COO

Yes, there are definitely differences and one of the dumbest things we could do is say, well, the market in the US is the same as the market in Latin America, and therefore pricing goes the same, structure goes the same. We don't do that. We look at each. We have the regions set up. Hector Alonzo is the regional president for Lat Am. He and his team are responsible for the business plan in that market and that they're accountable for making sure that their business plan is addressing the Latin America market, not some North America management team dictating how Latin America should be run. So there's a fair amount of autonomy. Hector has Latin America. James Heard has EMEA and we have each of those regions looking at the uniqueness.



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There are definitely differences. Datacenter services in Latin America are much more important to our customers than datacenter services combined with transport in North America. And so we leverage that difference and intend to invest in datacenters so that we take advantage of that need and really deliver the overall solution for customers based on the nuances and the uniqueness of each individual market.

Having said that, enterprise customers need largely the same things. They're going to an environment where more of their network is distributed. They don't have control over all of the applications. The applications are run somewhere else. They've either virtualized their servers or they bought cloud services. They've got every type of device in the world trying to connect to them and those needs are fairly consistent, Latin America, EMEA, and North America, and the need for security is fairly consistent, and managed services. And so we are positioning our product to recognize those needs. While the market may be slightly different, those needs are fairly consistent globally and people want that global solution. I want to know that the way I set up an office in Buenos Aires is the same way I set it up in London, and is the same way I set it up in Kansas City.

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**Michael Funk** - Bank of America Merrill Lynch - Analyst

But you do break down your business for us on a geographic basis so we can see the different rates of growth. Now, if you think about normalizing that, what are the barriers, say, in Europe? Is it supply, the number of competitors, the demand, its broadly economic product set, how you deliver that product? How would you rank order those different inputs?

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**Jeff Storey** - Level 3 Communications - President & COO

So for me, it's always execution. We had such a low market share, not wholesale, in enterprise. In enterprise, it's about execution. We're in such a low market share that the macro environment, while it affects people and it maybe changes their buying patterns, it also causes people to transition. If there are -- if I've got external pressures on my business as an enterprise customers and I know that I can transition off my existing type services and move toward IPV6 and then that's going to save me money, it might provide the impetus to make some of those moves.

So I look at our overall business execute and say, that's the key driver. The second driver would be our ability to manage off net vendors and in North America, in particular, our largest off net vendors haven't always performed as well as we would like for them to perform. That's a good thing because we compete with them. It's a bad thing when they're providing us services. So our ability to execute and then our ability to manage off net vendors are probably the two biggest concerns for me.

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**Michael Funk** - Bank of America Merrill Lynch - Analyst

Okay, and then to switching gears, thinking about M&A, obviously a lot of M&A in this space the last couple of years. What's your capacity to deal with another integration or merger right now?

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**Jeff Storey** - Level 3 Communications - President & COO

We have one rule at Level 3 that guides every decision we make. We're not going to do something that inhibits our ability to grow. We're not going to do something that messes with our ability to integrate Global Crossing successfully, and not only achieve the synergies that we talked about, but the revenue synergies that we hope for and the execution synergies that we hope for from the business. So that is a given that that trumps all else that we look at.

Having said that, there are lots of acquisitions that wouldn't impact that. And so we look at things. There are no particular acquisitions that come to mind, but we buy things for one of three reasons usually. There's a technology out there that we want or we need that we want to add to our capabilities. If we were to look at some small technology company, that wouldn't really be affected by the integration of Global Crossing. So it's not something that would really weigh in.





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We look at the ability to expand our footprint and expand our addressable market, whether that's by products or whether that's by deepening our footprint, or geographic expansion into some country or some territory that we don't serve. We look at those types of things. Those get a little more tricky and we would have to evaluate whether we were in a position to do one of those right now with Global Crossing integration. And then the last is, we look at companies for synergies where you can bring the companies together, layer their customers onto your network and reduce your overall cost to provide service. That's tricky as well. I wouldn't say that -- it would depend on the acquisition we were looking at, whether we're in a position to do it.

I will say that the -- we're very pleased with the integration of Global Crossing. We have a lot of early warning systems in place to tell us about problems that we're experiencing. We're tracking along very well with our synergy targets and we're tracking those milestones very well. So I'm not ready to go out and buy somebody tomorrow, but I think that it would be very specific about who we were looking at.

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**Michael Funk** - Bank of America Merrill Lynch - Analyst

We have about ten minutes left. Do we have any questions from the audience?

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**Unidentified Audience Member**

Hey, thanks. So just touching back on how the key revenue headwinds that you're facing is on achieving C&S revenue growth, and putting side the UK government, and putting aside FX, so constant currency. So on REIT pricing, how -- if we look at a constant portfolio of business today versus a year from now, how much would that be down in terms of price and how does that differ in terms of the enterprise component and the wholesale? And just any kind of color you can give on what the repricing dynamic is with your customers?

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**Jeff Storey** - Level 3 Communications - President & COO

So let me talk by product more so than by region. The -- if you look at the first quarter, that's when typically our repricing hits most. And our first quarter at historically Level 3 and Global Crossing had a [third] decline in the first quarter. Our first quarter this year didn't have that same level of decline. And so the repricing impact is getting less in some ways. If you look at each type of product that we have, pricing on infrastructure services, dark fiber co-data centers, those types of things, pricing environment is pretty solid and we think that there's a healthy pricing environment for us.

If we look at CDN and high speed IP, that's where we, and in particular in Europe, but that's where we've talked more about aggressive pricing declines. Then everything else is kind of in the middle and there are moderate pricing declines. Overall, pricing helps us -- pricing declines help us more than they hurt us because we have the scope, and scale, and the volume to take advantage of those declines in our -- historically we have a cost -- we have a 60% EBITDA margin. So for every dollar of revenue that we add, we get 60% incremental EBITDA margin. That continues in the face of the pricing declines that we've seen. So our cost to provide those services have come down at least at the same pace as the pricing has come down. Nobody -- we don't think anybody else has that same level of operating leverage and so price declines have somewhat helped us to win business, because we're continuing to deliver at that 60% EBITDA margin.

Pricing is fairly stable for a lot of the other products, waves, and transport services, and other things, but slightly declining as it has over the last few quarters.

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**Michael Funk** - Bank of America Merrill Lynch - Analyst

Just thinking about the customer churn, as well, can you walk us through a breakdown, maybe the churn rate for different products inside the customers? And associated with that, are you seeing more competitive activity in the last 12 months as you try to steal customers post-acquisition?



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**Jeff Storey - Level 3 Communications - President & COO**

No, I haven't seen more competitive activity. I haven't seen success with more competitive activity. I don't know what others have been doing necessarily, but we haven't seen an increase in churn as a result of somebody coming in and winning big customers of ours. Our churn is fairly healthy. We include in our churn numbers what we call good churn. As somebody disconnect one service to buy a higher-level service from us, we include those numbers in. And so, we're very pleased with our churn rates overall.

There's not any real breakdown of one customer versus another type. Financial services doesn't churn any more or any less than healthcare. Wholesale probably churns more than others just because it's a cycle. If they lose a customer they turn off a piece of the network and they buy something somewhere else as they win a customer. But by customer, I don't see any real significant differences in churn. We'll continue to work to improve it. We've done a lot of thing over the last three years to reduce our churn, making sure we're talking to our customers more frequently, making sure we're calling the customers and working with them not only six months before their contract is due but right after we finish their contract, and two months and three months in, working with them and making sure we're maintaining that relationship.

We've worked on our billing systems and our billing disputes, making sure we're giving a good bill to customers where they don't have any billing disputes. When they call in, their bill is good and clean. There's nothing that irritates a customer more than their billing being wrong. We reduced our billing disputes enormously, which helps our churn. So we have operational things that we're continuing to execute on that we think we'll continue to improve churn, but we're pleased with where it is and I don't see any real breakdowns by customer set.

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**Michael Funk - Bank of America Merrill Lynch - Analyst**

What's the impact, the financial impact of the SEC special access price freeze to Level 3?

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**Jeff Storey - Level 3 Communications - President & COO**

There's no real impact for Level 3 right now. We like the fact that incumbents aren't given any more flexibility to increase prices than they've already had. We use these people for off-net vendors. I guess the level of pleasure will be based on their level of displeasure. They seem to be very adamantly opposed to it, which probably means that that's good for us that they don't have that flexibility to raise prices. But we haven't seen any impact. We don't really predict any significant impact in the near term.

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**Michael Funk - Bank of America Merrill Lynch - Analyst**

Can you give us a sense on a pro forma basis how much Level 3's spending on special access has changed in the last few years? Or it's not even important to Level 3 anymore?

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**Jeff Storey - Level 3 Communications - President & COO**

Special access is definitely important to Level 3. One of the things that we do to gain capital efficiency is we don't build out our network to build buildings and then hope people are going to come into it. We sell services. When we get a customer, if we can turn up that building quickly enough, we'll turn up the building on fiber and never use an off-net service. If we can't turn it up quickly enough for whatever reason, we'll buy off-net services from somebody else. Or maybe the building doesn't justify it on a single customer. We'll win a couple of customers. We'll buy off-net services in there and then we will build our fiber and recapture those net [expenses]. That's what you see in our synergy -- our gross margin expansion over time is us going in and recapturing off-net expenses.

But it's important for us to use off-net providers in the meantime. We can't go everywhere and so it is a big component of our business. We have great gross margin. So it's not a component that we're totally dependent on, but it is part of our strategy to use off net to win, to accelerate growth, and then over time recapture that NetEx expense under our own backbone.





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**Michael Funk** - Bank of America Merrill Lynch - Analyst

Just remind me, what's your breakdown of the on net and off-net buildings today?

**Jeff Storey** - Level 3 Communications - President & COO

I don't have a clue how many off-net buildings we're in, but I think that the combined Company is somewhere around 13,000, give or take, on net buildings. And then I'd be wild guess as to how many off-net buildings we had.

**Michael Funk** - Bank of America Merrill Lynch - Analyst

Okay, and then thinking about the CDN business, obviously very small part of the revenue, 2%, 3% in total. There were a lot of headlines around Google's decision to try to move that capability in-house -- Netflix, I mean, not Google. How do you see that business trending over time even though it's certainly a growth engine for Level 3? Do you think more customers try to insource that?

**Jeff Storey** - Level 3 Communications - President & COO

Netflix is a very good customer of ours and they helped us build out our CDN capabilities by giving us huge amounts of traffic. But the natural flow of a lot of businesses is for somebody to outsource it until they get massive scale, and then they insource it themselves. That insourcing doesn't mean there's no business for Level 3. They don't have the connectivity and the interconnection to the rest of the world even if they insource their CDN business. But they've also left in place our scale of infrastructure and we are continuing to roll that out to other enterprise customers. We have a variety of CDN customers that have the ability to use that infrastructure that we put in place and use the capabilities that we put in place to meet their needs. More and more enterprise customers want website acceleration, they want CDN delivery. They have downloads, or video, or all of the different thing embedded in their websites and need our ability to scale.

One of the examples that we've used, and I've used in a public forum before maybe on an earnings call was the US Geological Survey, it's one of our CDN customers. How many of you have ever visited the US Geological Survey? Probably not many until there's an earthquake in Japan and then the number of hits that go out to the US Geological Survey spikes enormously, until there's an earthquake in Haiti and there's a volcano somewhere in the world. So those are the types of customers that have relatively low demand and then all of a sudden they have to spike to huge volumes. Our CDN is perfectly designed to help to help those types of customers. And so we, Netflix, if they ultimately insource that capability, that's kind of the natural evolution, but it leaves us a very large infrastructure and a lot of other services that we'll continue to sell to Netflix to help them enable the infrastructure that they're deploying.

**Michael Funk** - Bank of America Merrill Lynch - Analyst

And just one example, you had a dispute with a cable company a couple years ago about, I think in part, that traffic and that ate into the profitability I would assume of that business. Is this the kind of business now based on the resolution that it wasn't really that profitable anyway after paying for that traffic? Or how do we think about that?

**Jeff Storey** - Level 3 Communications - President & COO

Well, our dispute wasn't really about Netflix, but it was exacerbated by Netflix. The dispute is about whether people that have eyeballs have the right to introduce the tollbooth at the edge of their networks, and the dispute is about peering and the philosophy of peering. It's a very engineering arcane issue, but we've used directionality of traffic historically as the measure of value swap. Your traffic comes to me. If your traffic comes to me, I need to send you about the same amount and that equal distribution of direction is relevant. We don't think that's the case. How far I carry, how



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much I have to invest to carry that traffic is more relevant. And so, in part, in looking at our peering agreements we've been trying to evolve those peering agreements. Netflix just provided some of the -- maybe some of the pain point for some of those customers.

**Michael Funk - Bank of America Merrill Lynch - Analyst**

The catalyst.

**Jeff Storey - Level 3 Communications - President & COO**

The catalyst for the change. But Netflix has been a good customer for us. We expect them to continue to be and we expect to resolve, over the long-term, all of our peering relationships with those companies and have worked pretty hard over the last year, year and a half to do that. Although, we've been quieter about the resolutions than we are about the problem.

**Michael Funk - Bank of America Merrill Lynch - Analyst**

Okay. We're at the end of our time. So I want to thank Jeff again, once again for coming out to our conference.

**Jeff Storey - Level 3 Communications - President & COO**

Thank you very much.

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**Attachment 22**

12-Sep-2012

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Corrected Transcript

12-Sep-2012

## CORPORATE PARTICIPANTS

**J. Robert Fugate**

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

## OTHER PARTICIPANTS

**Michael J. Funk**

*Analyst, Bank of America Merrill Lynch*

## MANAGEMENT DISCUSSION SECTION

**Michael J. Funk**

*Analyst, Bank of America Merrill Lynch*

Seated as they transition rooms after the last meeting. Once again, Michael Funk with Bank of America Merrill Lynch. Thank you all for coming today for our presentation this afternoon. We have Bob Fugate from Cbeyond is with us. Once again we look forward to hearing about the transformation going on at Cbeyond as they move from more of a small business communications company, more to a provider of solutions for us, maybe what's tech focused small medium size business companies. So that'll probably be the main core of our conversation today but with that Bob will go ahead and kick it off.

**J. Robert Fugate**

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

Great. Thank you very much, Michael, great to be here.

**Michael J. Funk**

*Analyst, Bank of America Merrill Lynch*

May be you can – just to begin, maybe walk through that transition at Cbeyond. I know you've laid out a few a few different targets, maybe just remind us what these targets are, where you are relative to the target and then maybe some of the surprises along the way.

**J. Robert Fugate**

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

Sure. In February of this year, we laid out a course of transition in which we would move our business into a greater orientation on technology solutions for small businesses. And in particular, we identified last year, a great opportunity to serve technology dependent small businesses, ones who have more knowledge workers, remote workers. They have a greater dependency for information in their business and they have a propensity to outsource.

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We feel that that's about 40% to 50% of the small business market and that these customers have the opportunity to spend a lot more money with us than they have in the past. So it means that there's a big opportunity to upgrade the customer base that we have, as well as go out and attract a number of new accounts that represent a much bigger opportunity for us. And we can provide a much more valued role than being just a great communications provider. We can be the technology outsourcer for these companies. It's not an area that's really being served well today and we think that our business is very uniquely positioned to address it.

So some of the metrics that we laid out were that we expected that this – what we call our 2.0 revenue, will become about 25% of our revenue by late next year. Currently, in Q2, it was 6.8%. It's growing quickly. We also said that we would have – we'd be expanding the broadband capabilities that we could use to serve these accounts. And last year, we invested heavily in Ethernet-over-Copper. This year, we announced that we would be investing more heavily in fiber going forward. So we expect to have 1,000 buildings lit with – 1,000 lit buildings by the end of next year that we would construct and light. In addition, thousands of additional buildings are already available to us on a contract basis with fiber facilities. So the upgrade in the broadband capabilities and the ability to really control the access, as well as deliver cloud services via our own datacenters, is what I think separates us today.

**Michael J. Funk**

*Analyst, Bank of America Merrill Lynch*

And just really quickly on your 1,000 building target, I think you commented that was a – I think you said it was a sandbag goal, right, very easy goal to achieve at one point. What's a more reasonable goal than the 1,000 and how will that affect your CapEx?

**J. Robert Fugate**

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

Yeah, well, the typical word from the CFO is not sandbag.

**Michael J. Funk**

*Analyst, Bank of America Merrill Lynch*

Okay, I must have been paraphrasing.

**J. Robert Fugate**

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

So that might have been one of our other executives who could have used that word. It wasn't me. So, I would just say that, at this point in time, it's still early. The process to put those 1,000 buildings on net involves building access agreements and permitting and construction and there is a lot of steps. Logistically, we're just getting into the early stages of it. So, I think it's early to say to you, hey, the number is going to be different than 1,000 at this point. So at this point, the goals that we set out for 2013, I think, are definitely realistic for us. And we'll monitor and let you know how things go and at a later date and let you know if some of them need to be revised.

**Michael J. Funk**

*Analyst, Bank of America Merrill Lynch*

How did you pick the first 1,000? What were the metrics that you went down and decided these are the right 1,000 and these buildings didn't make it, what's the cut off?



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## J. Robert Fugate

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

Well, the first 1,000 buildings are primarily ones where we have three customers already. So, we have over 60,000 customers around the country in 14 major markets. In many of those cities, we have a very dense concentration of customers in certain geographic areas of the city. So, that means that there are a number of buildings, hundreds of buildings that have multiple customers of Cbeyond in them. Those are the best ones for us to go and put our own fiber in first, because it really makes sense economically. For us, it's the investment is justified simply on the existing accounts that we've got. But then the opportunity is to serve an additional seven, eight, nine, 10 more customers in those same buildings, with little or no additional expense.

So going forward, we think that with the opportunity to expand in the building, once we've got that beachhead of accounts that are already ours, that's a great margin opportunity. It's a huge revenue opportunity and we'll have the advantage having been the fiber provider in there. And most of the buildings, they are not the typical buildings that have been attracted by fiber providers to date, because these are not the high-rise, dense urban areas. They're more the suburban Class B, Class C type office buildings, that maybe – they have three to five floors, got a lot of small businesses in them. They're not ones that have been heavily built out to date. Many of them, we believe the majority of these 1,000 buildings, we'll be the first competitive fiber provider in that location.

## Michael J. Funk

*Analyst, Bank of America Merrill Lynch*

That's another target you had with what 125 Cbeyond 2.0 sales give light by year end. You obviously have a different sales process, as well as Cbeyond 2.0, going from very high velocity, high touch sales effort to more of a – more of a thoughtful sales approach. How is that going and where are you along the line of, I guess, developing that sales process and getting training out to the new people?

## J. Robert Fugate

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

Yes. Well, I will say that throughout our history, I think one of our strengths has been managing a direct sales force. And the historical – the traditional sales force that we've managed very high touch, high transaction, probably about a 30-day typical sales cycle, but still a very consultative approach and one in which we take a lot of pride. With the 2.0 opportunity, the customer is going through a process of evaluating a decision to give us much more of their IT spend. So, it is a longer sales cycle. It's in contrast to the communications decision, it's maybe three to five months versus a one month kind of sales cycle.

So, it is a more consultative approach from – than what we're doing on the traditional sales force. We've got over three quarters of the – well, I guess as of June 30, we had about 75, 76 of those 125 that we targeted by year end. So, we're well on our way to building up that sales force. They're under ramp and we feel very good about the opportunities that they're developing already and the revenue that's growing from them.

## Michael J. Funk

*Analyst, Bank of America Merrill Lynch*

Maybe just comparing CPGA from a Cbeyond 1.0 customer with a Cbeyond 2.0 customer, obviously very different equipment needs there may be the sales process compensation might be different.

## J. Robert Fugate

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

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Well, certainly on a per rep basis, the 2.0 sales force is a more expensive sales force. These are people with more experience in the industry. They come from different types of companies than where we had gotten them before. So, these are people with 10, 15 years of experience in the technology sector, companies like HP and Rackspace and Savvis.

So, certainly it's a bigger investment on a per person basis; however, the opportunity is much larger and we're going to be delivering. We already are bringing in accounts that will generate thousands of dollars a month, in some cases. So, for us, that's a big change. Our average revenue per customer currently is in the \$640 per month range and this is something where we're not trying to reduce the cost to add a new customer. We're trying to bring in a much richer account.

And over time, we think that the leverage on this new sales force will enable us to see better margins and certainly also a stickier account, although we think the customer retention historically has always been strong. I think it can even be better with this new type of focus that we've got.

So, CPGA is not a specific metric that we speak to quantitatively. You guys on the sell-side probably have your estimates of that. But I think the main driver for us going forward is to see the ARPU increase. And over time, I'm confident that'll pull up margins as well.

## Michael J. Funk

*Analyst, Bank of America Merrill Lynch*

And then, how do you think about linking the two different models, Cbeyond 1.0 and 2.0? How do we think about the cash flow trending to even troughing during that period of time? You're going to have obviously a higher cost associated with the new sales force coming on board. You have declining Cbeyond 1.0 ARPU and customers presumably over time. On your estimates, when and where does the cash flow reach a bottom to Cbeyond?

## J. Robert Fugate

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

Yeah, well, let me speak to it this way. This year, we are in the process as we shift the resources from the large 1.0 sales force to a smaller 1.0 sales force and a growing 2.0 sales force, it means that there is a shift in emphasis. It means that there is a bit of shift in terms of – in the past, we were looking at greater volumes of smaller ARPU units. Now, we're looking – we're moving away from that orientation on units and much more toward quality of revenue. We're not really that interested in the number of units coming in the door as we were in the past.

The homogeneity of the customer base is different today and I think that what will result is a much healthier business. We've stated that we'd have a couple of quarters here of slightly down to flat revenue after the first half of this year. So, revenue in the back half in total undergoing that transition before it moves into a position, I think, early in 2013, where revenue in total will be growing again. And I'm excited about the opportunity to see revenue growing into once again the high single digits and low double digits on a year-over-year basis, perhaps late next year and as we move into 2014 become much more of a higher growth revenue business again.

## Michael J. Funk

*Analyst, Bank of America Merrill Lynch*

And then you talk some of the ARPU for Cbeyond 1.0, I think they had been declining at a faster rate than it did last quarter, how should we think about that going forward from the pressure points on the ARPU from Cbeyond 1.0?



Cbeyond, Inc. (CBEY)

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## J. Robert Fugate

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

Yeah. Well, ARPU has, I think over the last couple of years, probably been a primary interest or concern of investors. We saw last year the decrease in the rate of ARPU decline, so the drops we were seeing on a quarterly basis had been steadily narrowing. And I think we are in a position now where you could argue that we've entered much more of a stable ARPU period of time that I think is a – it's a preface to again as I was mentioning with total revenue, I think you will see a point in the next few quarters probably early next year when ARPU may start to rise again. And the catalyst for that is just simply the growing momentum and ways that we think we're seeing with 2.0 accounts who spend more with us and the evidence for it is that in Q2 those accounts had an ARPU of over \$840 versus \$640 roughly of our total base, and it's growing. It's growing every period; I fully expect that at the end of Q3, you'll see a steady strong growth in that 2.0 ARPU again. And I don't when, what that will ultimately reach, but I feel like there are many quarters ahead of us in which this is going to be the trend and one in which we can count on that pulling up the total.

## Michael J. Funk

*Analyst, Bank of America Merrill Lynch*

And as we think about that legacy base, is there room somewhere in the future in your mind to actually increased prices? We've seen throughout the history in telecom that towards the tail end of a product or if a customer base, they tend to have a longer average life time and are very sticky and less sensitive to price increases. Is there a room in your mind to increase pricing on that base?

## J. Robert Fugate

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

It's still very price competitive. We aren't going; we aren't trying to attract the bottom end anymore, certainly. We never really had that as a goal, but we, I would say we backed our way into being in that price game for a period of time. Although that's not a focus, we have a customer base that I think we'd like to retain. And for one reason is that, many of those are accounts that we think can grow over time and many of them we can up sell.

And the kinds of things we can up sell, it's interesting that although not every account is going to need to, have the need to put servers that they have in a closet off-site in a datacenter. It is true that just about every account has a phone system, and one day they're going to upgrade that phone system. There's no reason why any small business should have a phone system on its premise anymore and we have a great alternative for that. We call on them in person, we make the process easy for him, we've got a great product. So, many of those accounts are great opportunities for us to bring on to your cloud PBX product. In order to keep them and have them poised for that, we need to be competitive in our pricing. So I think it would be premature to – probably to think of a price increase at this point.

## Michael J. Funk

*Analyst, Bank of America Merrill Lynch*

And then as you go to market, I mean what's your value proposition versus traditional network within cloud computing companies and how do you sell against each one?

## J. Robert Fugate

*Executive Vice President, Chief Financial Officer, Cbeyond, Inc.*

Yeah, well, in terms of network competitors what – for the most part, the cast of characters is really you've got a number of competitive providers out there that do a good job, but for the most part they aren't really offering a